Supreme Court of the United States

OCTOBER TERM, 1944

No. .....

COOPERSTOWN CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions of the Courts Below.

The opinion of the Board of Tax Appeals appears at pages 16a to 19a of the record. Copies of the opinions of the Circuit Court of Appeals, which have not yet appeared in the Federal Reporter, are printed in the appendix to this brief (*infra*, pp. 25-31).

Jurisdiction.

The statement as to jurisdiction given in the petition is hereby adopted and made a part of this brief.

Statement.

The statement of the case already given in the petition under the heading of "Summary Statement of Matter Involved" is hereby adopted and made part of this brief.

We may add here a quotation from the petition to the Board of Tax Appeals and from the respondent's answer to show that the question of petitioner's legal liability to pay the capital tax in 1937 was admitted and was not in issue before the Board. The petition for review of the alleged income tax deficiency sets forth (R. 3a):

> "5. The facts upon which the petitioner relies as the basis of this procedure are as follows:
>
> (a) The taxpayer made its income tax returns on a cash basis and not on an accrual basis;
>
> (b) It was assessed by the Commissioner of Internal Revenue for a capital stock tax in 1937 in the sum of $7,000 and it paid said capital stock tax of $7,000 in 1937".

These facts were affirmatively admitted in respondent's answer as follows (R. 11a):

> "5. (a) and (b). Admits the allegations of paragraphs 5(a) and (b) of the petition."

It may be pointed out also that there was nothing capricious in the filing by petitioner of a capital stock tax return. Even after deducting the capital stock tax of $7,000, petitioner had a *net income* in 1937 of $169,680.12 (R. 8a).

Specifications of Errors.

1. The Circuit Court of Appeals erred in holding that petitioner was not entitled to deduct on its income tax return for 1937 the amount of the capital stock tax assessed against and paid by it in that year, even though claim for refund thereof made in 1938 was allowed in 1939 and the capital stock tax was refunded in that year.

2. The Circuit Court of Appeals erred in holding that the allowance of said claim for refund in 1939 established

conclusively that there was no liability for said capital stock tax in 1937.

3. The Circuit Court of Appeals erred in deciding this case on the question of whether or not there actually was a legal liability of petitioner to be assessed for capital stock tax in 1937, since that question was not raised either by the petition to the Board of Tax Appeals or by the answer thereto and was not tried in the Board and there was no finding of fact of the Board on that subject.

Summary of the Argument.

The points of the brief are summarized in the subject index (pp. i, ii).

POINT I.

Petitioner, having made its returns on a cash receipts and disbursements basis, and having been assessed for a capital stock tax in 1937 which it paid in that year, is entitled to retain a deduction for such payment made on its income tax return in 1937, even though said capital stock tax was refunded in 1939.

The fundamental principle that each taxable year is a unit for taxation of income taxes has been often declared and applied in this Court. Its rationale may be summarized as follows: Income taxes are payable with respect to the results of each separate year taken as a unit. Accordingly, whether an income tax return be made on a cash basis or on an accrual basis, the return either is right or is wrong when the return is made, dependent *solely* upon the fact situation at the close of the taxpayer's taxable year; and, therefore, no fact supervening after the close of the taxpayer's taxable

year can make right a return which was wrong when made, or can make wrong a return which was right when made.

The Board of Tax Appeals found as a fact, based upon the allegation of the petition affirmatively admitted in the answer, and upon stipulation of the parties, that the capital stock tax here in question had been assessed against petitioner in 1937 and had been paid by petitioner in 1937 (R. 17a). At the close of the year 1937 it is impossible to doubt that petitioner, making its returns on the cash receipts and disbursements basis, was entitled to a deduction for the capital stock tax assessed against and paid by it. That being established, it follows that later events, that is, the filing of a claim for refund in 1938, the allowance of that claim in 1939, and the repayment of the tax in 1939, could not affect the correctness of the income tax return rendered by petitioner in 1937. Petitioner thereafter correctly returned the amount of said tax *refund* as part of its income for the year 1939.

In a series of cases decided by the Board of Tax Appeals in 1941 and thereafter, beginning with *E. B. Elliott Co.*, 45 B. T. A. 82, the Board of Tax Appeals departed from these principles in the case of taxpayers rendering returns on the accrued basis, so as to allocate to each year items of income or of expense to which they might seem logically to *appertain,* whether or not they legally *accrued* in those years; and in the case of *Louisa Co.* v. *Commissioner,* 45 B. T. A. 1056, followed by it in the instant case, the Board extended this practice to taxpayers making their returns on a *cash* receipts and disbursements basis. The error of these decisions was corrected by this Court in *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, where it said at pages 286, 287:

> "The question is not whether the Board within its discretion made a determination of fact. Compare

Dobson v. *Commissioner*, 320 U. S. 489. It is rather whether, as matter of law, the Board misconstrued the extent of the power conferred by the Revenue Act.

> 'All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.'[9]

The rationale of the system is this: 'It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation.'[10]

This legal principle has often been stated and applied.[11] The uniform result has been denial both to government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount.[12]

But the petitioner urges that Section 43 has altered the rule so that a hybrid system, partly annual and partly transactional, may, within administrative discretion, be substituted for that of annual accounting periods. It urges that the change was

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[9] *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363.

[10] *Id.*, p. 365.

[11] See e.g. *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115, 120; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 306; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326; *Tait* v. *Western Maryland Ry. Co.*, 289 U. S. 620, 624; *Brown* v. *Helvering*, 291 U. S. 193; *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493, 498.

[12] See the cases cited Notes 5, 9 and 11.

> due to the desire of Congress to prevent distortion of true income. This must mean distortion of true income, not of a given year, but, in the light of ultimate gain, from a series of transactions over a period of years, growing out of, or in some way related to, an initial transaction in the taxable year. The very section on which petitioner relies, however, reiterates the adherence of Congress to the system of annual periods of computation."

As pointed out in the accompanying petition, since the decision of the *Security Flour Mills Co.* case, the Tax Court has abandoned the practice which it initiated in *E. B. Elliott Co., supra,* and in a case indistinguishable from the instant case has sustained the right of a taxpayer to retain a deduction for taxes erroneously paid but later refunded, the amount of such refund being regarded as income in the year in which the refund was received. *Stanard-Tilton Milling Co.* v. *Commissioner,* 3 T. C.—No. 127, June 23, 1944.

This rule applies with redoubled force in the case of a taxpayer making his return on the cash receipts and disbursements basis. Such a taxpayer necessarily must account for all items of income received in the year of their receipt even though payments may have been made to the taxpayer under a mistake of law or a mistake of fact and even though for that reason the person making the payment to him may be entitled to and may ultimately receive a refund. In the same way, actual payments made by a taxpayer on the cash receipts and disbursements basis of a type giving rise to deductions, such as business expenses, interest, taxes or losses, are deductible in the year in which paid even though it may later turn out that such payments were made under a mistake of fact or of law and are recoverable. In practically every case where a payment is received or a payment is made under a mistake of fact or of

law, the question of whether the payment is recoverable is a doubtful one. It is contrary to human experience that, unless moved by a donative intent, people pay out money for which they are not or do not believe themselves to be legally responsible.

In accordance with the new type of deviation from the rule of determining income tax liability on the annual unit basis, proposed and applied by the court below, the question of a taxpayer's income tax liability is not one to be determined by cash receipts and disbursements or even by whether a taxpayer has in a later year *actually* received or paid a refund of moneys erroneously paid or received by him; for the court below says that the Commissioner might properly have reached same result in this case "Even had no claim for refund been made or as yet allowed." In other words, actual payment of deductible items or, by parity of reasoning, actual receipt of income items, do not determine the income tax liability even of a taxpayer on a cash receipts and disbursements basis, but his tax returns are to be subject to constant readjustment and change based upon the Commissioner's view as to whether or not the taxpayer could have asserted a defense against a payment actually made by him or was subject to a valid claim to make repayment of amounts actually received by him as income.

This view, we submit, is an even more dangerous innovation and encroachment upon the rule of annual determination of liability for income tax than the practice which this Court condemned in the *Security Flour Mills Co.* case, following an unbroken series of decisions of this Court; and if this view were to be permitted to gain a foothold, it would again plunge into the realms of uncertainty substantially every income tax return made by every taxpayer.

POINT II.

The assessment of the capital stock tax in 1937 made it a legal and inescapable obligation in that year.

We have seen that the petition to the Board of Tax Appeals alleges that petitioner "was assessed by the Commissioner of Internal Revenue for a capital stock tax in 1937 in the sum of $7,000 and it paid said capital stock tax of $7,000 in 1937" (R. 3a) and that said allegation was affirmatively admitted by respondent in his answer (R. 11a). The same fact was also stipulated by the parties and found as a fact by the Board.

That this assessment created a legal liability of the most peremptory nature is unquestionable. *Graham* v. *DuPont*, 262 U. S. 234; *Phillips* v. *Commissioner*, 283 U. S. 589, 595, 596.

The fact that the tax may have been assessed erroneously made it no less a tax when it was paid. Petitioner could not enjoin its collection (Revenue Act of 1928, Sec. 617, 45 Stat. 877) and if petitioner had not paid it, collection could have been enforced by distraint (Revenue Act of 1934, Sec. 701 (d), 48 Stat. 769; Revenue Act of 1926, Sec. 600, 44 Stat. 93; R. S. Sec. 3187).

Accordingly, even adopting what we assail as the spurious test proposed in the opinion of the court below, which makes legal liability as ultimately ascertained rather than actual payment the criterion, the capital stock tax was deductible by petitioner in 1937 because, due to the assessment of said capital stock tax in 1937, petitioner was in 1937 under a positive and, indeed, an incontestable legal liability to pay said tax.

The court below was in patent error when it held that the making of the refund in 1939 "conclusively estab-

lished" that there was no legal liability to pay the capital stock tax in 1937. In the first place, the making of the refund in 1939 did not and could not retroactively relieve the binding force in 1937 of the assessment of the capital stock tax made in that year by respondent. In the second place, the making of a tax refund establishes nothing with respect to actual liability, because if it should appear to the Commissioner at any time within two years after the making of the refund that the tax refunded was actually owing and that the refund had been made in error, the Commissioner is expressly authorized by statute to bring suit for the recovery of the tax refunded (Internal Revenue Code, Sec. 3746).

POINT III.

Whether or not petitioner was in fact and in law liable to assessment for capital stock tax for the year 1937 was not in issue before the Board of Tax Appeals, was not tried before the Board of Tax Appeals, and that Board made no findings on the subject and, accordingly, the Court below was in error in basing its decision upon its assumption with respect to that matter.

Since petitioner was assessed for capital stock tax in 1937, it seems to be utterly immaterial to the decision of this case whether or not such assessment was in fact or in law erroneous.

Assuming, however, that that question might be material, if properly raised, it could not be made the basis for a decision by the court below because it was not in issue in the Board of Tax Appeals, which made no finding on the subject. *General Utilities Co.* v. *Helvering*, 296 U. S. 200;

Helvering v. *Wood*, 309 U. S. 344, 349; *Helvering* v. *Cement Investors, Inc.*, 316 U. S. 527, 535.

Even apart from the assessment made in 1937, in the absence of any evidence on the subject, petitioner was presumptively liable for the capital stock tax in 1937.

Pursuant to Regulations 64 (1936 edition) promulgated by the Secretary of the Treasury relating to capital stock tax, every corporation in existence during any part of a taxable year was required to file a capital stock tax return for that year, except in cases where the corporation had previously received a letter from the Commissioner specifically exempting it from filing a capital stock tax return (Art. 32). Article 42 of these Regulations established the presumption that every corporation organized for profit was engaged in doing business. We quote excerpts from Article 42:

> "Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. * * *
>
> The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one in which the corporation is not pursuing the ends for which organized, i.e., profit."

Article 73 of the Regulations sets forth in detail the voluminous material required to be submitted to the Commissioner by a corporation organized for profit if it attempts to secure exemption from the payment of capital stock tax, such enumeration being preceded by the following warning:

> "As corporations are generally organized to do business, every corporation is presumed to be sub-

> ject to the tax unless it submits evidence satisfactory to the Commissioner that it has not carried on or done business during any part of the taxable year. Accordingly, exemption from the tax must be established by an official ruling by the Commissioner."

Article 74 suggests in terms that where a corporation organized for profit seeks to claim exemption on the ground that it was not engaged in business, it would be preferable to make the claim in a claim for refund because if the claim for exemption is denied, interest on the tax accrues at the statutory rate from the due date and not from the date when the exemption was rejected.

Whether or not petitioner was legally liable to assessment for capital stock tax for the year 1937 was dependent upon whether in accordance with the actual facts relating to its activities, or lack thereof, which resulted in the acquisition by it of net income during said year of approximately $170,000, it met the strict test asserted by this Court in *Magruder* v. *Washington, Baltimore & Annapolis Realty Company,* 316 U. S. 69, reversing 120 F. (2d) 441.

The conclusion of the court below that petitioner's actual non-liability for the payment of capital stock tax in 1937 was "conclusively established" by the refund of the capital stock tax has already been shown to be wholly lacking in foundation (*supra,* p. 21).

Consequently, in the absence of any issue, proof or finding on the subject in the Board of Tax Appeals, the court obviously could not make this case turn upon whether or not the assessment of capital stock tax made against petitioner in 1937 was or was not erroneous.

The very fact, however, that the decision of the court below in its nature would require the determination of this difficult collateral matter before there could be established the correct income tax liability of petitioner for the year

1937, petitioner being on the cash receipts and disbursements basis, is eloquent and conclusive proof that the whole theory of the court below is erroneous, that it introduces a new and dangerous element into the decision of income tax cases, resulting necessarily in widespread confusion and delay in determining income tax liability, and that it is in the highest degree desirable that the decision of the court below be reviewed in this Court.

Conclusion.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals for the Third Circuit and finally reverse it.

Dated, September 23, 1944.

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